In the Supreme Court of the United States

OCTOBER TERM, A. D. 1944.

No. 698.....

IN RE WARNER COAL CORPORATION, DEBTOR.

WARNER COAL CORPORATION,

Petitioner,

vs.

COSTANZO TRANSPORTATION COMPANY, *et al.,*

Respondents.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Fourth Circuit, and
BRIEF IN SUPPORT OF PETITION.

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IN RE WARNER COAL CORPORATION, DEBTOR.

WARNER COAL CORPORATION,

Petitioner,

vs.

COSTANZO TRANSPORTATION COMPANY, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, The Chief Justice and the Associate Justices of the United States:

Petitioner, Warner Coal Corporation, hereby petitions for the issuance of a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit, whose judgment was made final on October 2, 1944, when it denied a rehearing of its decision of August 4, 1944, affirming the judgment below.

STATEMENT OF THE MATTER INVOLVED.

This is a controversy arising out of involuntary bankruptcy proceedings brought against Warner Coal Corporation, a West Virginia corporation, in the United States District Court for the Northern District of West Virginia at Wheeling. Petitioning creditors together with Ohio Edison Company, an intervening creditor, now are respondents. They contended in the District Court that Warner Coal Corporation, while insolvent, committed an act of bankruptcy by its failure to satisfy, within thirty

days, an attachment lien obtained by Ohio Edison Company on June 17, 1943, in the Common Pleas Court of Cuyahoga County, Ohio (R. 5).

Three other alleged acts of bankruptcy which were asserted are not pertinent here because of the rulings of the courts below. The creditors' petition was filed October 9, 1943 (R. 3), all but four months after the date of the alleged acts of bankruptcy in June, 1943. This was at the time when Warner Coal Corporation had just completed an extensive program of rehabilitating its mines (R. 41, 46).

Warner Coal Corporation answered the involuntary petition against it and denied its insolvency (R. 9, 11). It also demanded a jury trial (R. 16). During the trial, the District Court granted motions made by petitioning creditors to exclude from consideration in determining solvency, all evidence of the value of the Coal Company's leasehold and of its mining machinery and equipment acquired by bill of sale from lessors (R. 17, 29).

The motions were based on the contention that in the event debtor was adjudicated a bankrupt, lessors would then have the right to cancel the lease, regain possession of the mines and seize the equipment therein. If this should occur, the properties would not be available to satisfy creditors' claims. The Coal Company proffered testimony that the fair value of its leasehold was $61,457.87 and of its machinery was $292,400.32 and that it was solvent. By the terms of its lease the Coal Company had the right to use a very large amount of other machinery with which the mines were equipped. This other machinery was not claimed as an asset and no testimony was offered by any party as to its value.

Warner Coal Corporation had leased, for twenty years commencing September 1, 1942, two large coal mines, one known as Richland and the other as Costanzo, located on the Ohio River just at the outskirts of Wheeling (R. 114). By bill of sale, Warner Coal Corporation acquired title to

certain specified machinery and equipment located in the Costanzo mine (R. 123). The leasehold and the machinery represented over 90% of the debtor's assets (R. 129).

The trial court directed the jury to return a verdict that Warner Coal Corporation was insolvent and that it had committed an act of bankruptcy in failing within thirty days, to satisfy an attachment lien obtained by Ohio Edison Co. (R. 18). The verdict was so returned by the jury (R. 20). The court then adjudicated Warner Coal Corporation a bankrupt (R. 21). The Circuit Court of Appeals affirmed the judgment of the District Court (R. 186).

JURISDICTION INVOKED.

The jurisdiction of this Court to grant the Writ is invoked under 240 (a) of the Judicial Code, 28 U. S. C. A., Sec. 347 (a). The judgment of the U. S. Circuit Court of Appeals for the Fourth Circuit affirming the decision below was rendered August 4, 1944 (R. 187), and was made final by the denial of the Petition for Renearing on October 2, 1944 (R. 217). This petition is filed within the statutory period.

OPINIONS BELOW.

The opinion below of the District Court was not published. It appears in the Record at page 18. The opinion of the Circuit Court of Appeals is published in the advance sheets of the Federal Reporter, 144 F. (2d) 589, and appears in the Record at page 187.

THE QUESTIONS PRESENTED.

1. In determining solvency in an involuntary bankruptcy, does the debtor have a right to submit to the jury evidence of the fair value of the debtor's twenty-year leasehold, not in default, and of its machinery and equipment, notwithstanding a provision of the lease that, if the debtor be adjudicated bankrupt, lessor would have the

option to cancel the lease and repossess the premises, including machinery and equipment?

2. In determining solvency in an involuntary bankruptcy, involving a debtor company, which, at the time of the alleged act of bankruptcy, was in possession of and using its leasehold and machinery in connection with its mining business, does the debtor have a right to submit to the jury evidence of the fair value to a going concern of its twenty-year leasehold, not in default, and of its machinery and equipment, notwithstanding a provision of the lease that, if the debtor be adjudicated bankrupt, lessor would have the option to cancel the lease and repossess the premises, including the machinery and equipment?

3. In the review of an involuntary bankruptcy case, with facts as presented in the preceding question, may the Appellate Court substitute itself for the jury and consider the proffered evidence of fair value to a going concern which the trial court excluded from the jury, and on such consideration fix the value of debtor's property at the amount of cash paid for it, rather than in accordance with the proffered evidence of its fair value to a going concern?

REASONS FOR ALLOWANCE OF THE WRIT.

This case presents a conflict with the decisions of two other Circuit Courts involving fundamental questions concerning the all important issue of solvency in an involuntary bankruptcy proceeding. There is no conflicting testimony as to the value of debtor's property. The District Court held that by reason of the terms of the lease, the debtor's most important assets, in the event of adjudication of bankruptcy, would not be readily available to creditors and therefore could not be considered as property in determining solvency (R. 17 and Clause 17 of lease R. 117).

The Fourth Circuit Court of Appeals affirmed the judgment of the District Court.

Conflict with Fifth Circuit.

The decision in this case is directly in conflict with the ruling of the Fifth Circuit Court of Appeals in the case of *Lasswell v. Stein-Block Co., et al.,* 93 F. (2d) 322, decided in 1937. In that case, the Fifth Circuit Court held that the word "property" in Sec. 1 (19) defining insolvency is used in a broad sense and is not limited to property available to pay the bankrupt's debts.

The Bankruptcy Act specifically defines insolvency:

Sec. 1 (19) of the Bankruptcy Act, 11 U. S. C. A. 1 (19):

> "A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts."

In the *Lasswell* case, the appellant contended that debtor's homestead should not be included in determining solvency, because in Texas a homestead cannot be sold by the owner, if a married man, (as the debtor was), without the consent of his wife, and was therefore not available to creditors. The Fifth Circuit Court specifically overruled that contention and held that:

> "Conceding the nature of a community homestead in Texas and the husband's lack of power to alienate it without the consent of his wife, we hold that such exempted homestead should be included in computing solvency since there is no indication of Congressional intent to exclude any property other than that conveyed or concealed to hinder or delay creditors."

Conflict with Sixth Circuit.

The decision of the Fourth Circuit Court is also in conflict with the ruling of the Sixth Circuit Court of Appeals in the case of *Re Nathanson Bros. Co.*, 64 F. (2d) 912, decided in 1933. We quote the third syllabus from the *Nathanson* case:

> "If business of alleged bankrupt is, in fact, being conducted at time of alleged bankruptcy, then items of property constituting its assets must be considered as property of 'going concern' for purpose of determining whether alleged bankrupt is solvent."

On September 1, 1942, Warner Coal Corporation commenced the operation of its mines under the terms of its lease (R. 26, 27). The Coal Company continued to operate its properties and made substantial improvements therein right up to October 9, 1943, the date on which involuntary bankruptcy proceedings were commenced (R. 3, 46, 130, 134). The District Court promptly appointed an operating receiver who took charge of the property and resumed the mining and sale of coal. When the District Court adjudicated the Coal Company a bankrupt, the operating receivership was terminated and the same individual, A. Spates Brady, was appointed receiver for Warner Coal Corporation, a bankrupt. He is presently operating the mining properties.

The Coal Company was conducting its business at the time of the alleged act of bankruptcy and was therefore entitled to have its assets considered as property of a going concern for the purpose of determining solvency. The judgment of the Fourth Circuit Court affirmed the District Court, in excluding all testimony concerning the fair value to a going concern of debtor's chief assets, namely its leasehold and mining equipment (R. 17, 186).

Effect of Judgment.

If the judgments of the lower courts in this case represent the law, then businessmen must make a drastic departure from generally accepted standards in estimating the worth of their capital assets. No longer will it be safe for an accountant to certify that a going concern has any value in its leasehold or any value in machinery which it owns outright if, under the terms of the lease, an adjudication of bankruptcy would give the lessor the option to cancel the lease and repossess the premises, including machinery and equipment located therein.

The judgment of the Fourth Circuit Court in this case is directly in conflict with the decisions of the Fifth and Sixth Circuit Courts in the cases just mentioned. The Supreme Court has not passed upon these questions.

PRAYER FOR RELIEF.

WHEREFORE, the petitioner, by its counsel, prays the issuance of a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit, to the end that the judgment may be reversed and for such other relief as to the Court may seem fit.

ROBERT J. BULKLEY,
JAMES A. BUTLER,
Counsel for Warner Coal Corporation.

BRIEF IN SUPPORT OF THE PETITION.

STATEMENT OF THE CASE.

Warner Coal Corporation was organized under the laws of West Virginia in August, 1942, for the purpose of taking a twenty-year lease to certain coal lands and operating two long established mines located thereon, just at the outskirts of Wheeling. The coal mines are known as Richland and Costanzo. They are on the Ohio River, in the Panhandle area of West Virginia.

On September 1, 1942, the Coal Company took over the operation of the mines from the previous operators who are the lessors. The lessors are three West Virginia Corporations, controlled and operated by Frank and Louis Costanzo (R. 38).

Ohio Edison Company, an electric utility with headquarters at Akron, serves several counties in eastern Ohio, particularly the Akron and Youngstown areas. Edison operates a very large generating station at Toronto, Ohio, on the Ohio River. This station is about thirty miles upstream from the Richland and Costanzo mines. For about fifteen years, Edison had been purchasing substantial tonnages of coal from the Richland and Costanzo mines. Because of the low freight rates afforded by river barge transportation, Edison was able to save approximately 35¢ per ton on coal purchased from these mines compared with other coal of comparable quality.

On August 31, 1942, Edison advanced $100,000 to the newly organized Coal Company and took in exchange therefor a receipt for pre-paid coal (R. 181). On February 20, 1943, Edison made a similar advance of $25,000 more to the Coal Company for which it also took a receipt for prepaid coal (R. 182). In this manner, Edison had an investment of $125,000.00 in Warner Coal Corporation.

The Coal Company paid $10,000 to the Costanzos for the twenty-year leasehold which became effective Septem-

ber 1, 1942 (R. 114 and 120). It also paid $90,000 to the Costanzo interests for certain specifically described mining machinery and equipment located in the older or Costanzo mine (R. 121 and 123), and received from the lessors an absolute and unencumbered bill of sale dated October 20, 1942 (R. 123).

The opening paragraph of the lease (R. 114) recites the full corporate name of each of the lessor companies together with the abbreviated names by which they are referred to in the lease as follows:

> "* * * Wheeling Valley Coal Corporation * * * referred to as 'Wheeling Valley,' Wheeling Coal Company * * * referred to as 'Wheeling,' and Costanzo Coal Mining Company * * * referred to as 'Costanzo,' all West Virginia corporations of Wheeling, Ohio County, West Virginia, lessors."

Clause 9 of the lease (R. 116) commences as follows:

> "It is understood that the Lessee is acquiring, under separate agreement, title to all the machinery, tracks, power houses, tipples, supplies, accessories and all other fixtures, equipment and articles heretofore sold by Wheeling to Costanzo."

This machinery was all located in the Costanzo mine, and is that referred to in the bill of sale, which conveyed to the Coal Company absolute and unencumbered title upon payment of $90,000 (R. 121, 123). By the terms of the lease, the Coal Company also had the right to use all the rest of the machinery located in the two mines (R. 116, 117). The debtor does not claim this additional machinery as an asset.

The lease provided that the Richland and Costanzo mines together were then equipped with machinery capable of producing a total of 70,000 tons of coal per month. The Coal Company agreed to pay to the lessors a royalty of 12¢ per ton (R. 115). The parties estimated that there were ten million tons of unmined coal in the premises

covered by the lease. Over the twenty-year life of the lease, the royalty would amount to $1,200,000. Royalty was to be paid as the coal was mined. However, the lessee agreed to pay royalty on a minimum of 42,000 tons per month.

It was agreed that at the termination of the lease, when the royalty on the ten million tons of unmined coal had been paid, the lessors should then convey to the Coal Company title to *all* the machinery in the mines. The language used in the lease at this point is not as clear as could be desired. Part of the machinery, namely that described in the bill of sale, has already been conveyed to the lessee. The lessor's obligation can only be to transfer to lessee, at the termination of the lease when all the unmined coal shall have been paid for, that portion of the machinery in the mines not previously conveyed to the Coal Company. The third paragraph of clause 9 of the lease reads as follows (R. 116, 117):

> "It is understood that the two mines covered by this Lease are equipped with machinery, equipment, supplies, tracks, power houses, tipples and accessories to mine and prepare 70,000 tons of coal per month. If and when Lessee mines or pays for all the coal required by Section 5 of this Lease, Lessors will convey to Lessee all of the machinery, equipment, supplies, tracks, power houses, tipples and accessories included in this Lease inside and on the surface of said two mines and the same may thereafter be removed by Lessee at any time during the period or after the termination of this lease."

It was agreed by the parties that the machinery would be kept in repair and replaced as worn out, by the lessee. As a safeguard against the failure of fulfillment of the obligations undertaken by the lessee, the lessors required that the mines should be maintained with sufficient machinery to produce 70,000 tons of coal per month; as they were at the time the lease went into effect. The fourth

and fifth paragraphs of clause 9 (R. 117) cover this point. They read:

> "In the event that, prior to the date when Lessee has mined or paid for all the coal required by Section 5 of this lease, any of the tipples, machinery or other equipment is removed from the leased premises by reason of being worn out or obsolete, or to conform to the mining or operating plans of Lessee, Lessee will replace the equipment removed with the necessary equipment to maintain the leased premises in a condition capable of mining and preparing at least seventy thousand (70,000) tons of coal per month. In such event, however, the machinery or other equipment removed shall be the property of Lessee.
>
> In the event that this lease is terminated for any reason before all of the coal required by Section 5 of this lease is mined or paid for, Lessee must surrender the leased premises to Lessors, sufficiently equipped with equipment and supplies, standard to that time, to mine and prepare seventy thousand (70,000) tons of coal per month, but may remove as its own property any equipment in excess of such amount."

The Coal Company promptly commenced a program of rehabilitation and improvement of the leasehold and of the machinery. This work was begun in October, 1942, and continued without interruption until involuntary bankruptcy proceedings were filed on October 9, 1943. During that period $84,076.22 was spent by way of capital improvement to the Coal Company properties above and beyond normal maintenance (R. 73, 86, 87, 130).

During the first year of operation of these properties by the Coal Company several events occurred which materially affected the anticipated profitable operation of the mines. The Coal Administrator of the United States ordered all operating companies to increase their work week from five days to six. This entailed paying wages at one and one-half times the regular rate for the sixth day and substantially increased the cost per ton mined. About

four months later OPA granted the Coal Company a price increase of 25¢ per ton to relieve this situation.

On May 1, 1943, the United States Government took over the operation of all coal mines in the country. Despite the take-over by the Government, work stoppages occurred in May and in June, 1943. During those periods when the miners refused to work, very heavy maintenance expenses continued. This is because safe operation of the mines requires constant forced ventilation of fresh air through the mines and constant pumping to prevent accumulations of water. In the forepart of June, 1943, costs were substantially in excess of realization from sales (R. 164).

Faced with this situation, the Coal Company posted a notice at its mines that at 12:01 A. M., June 16, 1943, the production of coal would be suspended until 4:00 P. M., June 22, 1943 (R. 184). On June 17th, Ohio Edison Company filed suit against the Coal Company in the Common Pleas Court of Cuyahoga County, Ohio, asking damages for alleged breach of contract in the sum of $261,000.00. It also filed an affidavit for attachment against the Coal Company's Ohio bank account, on the grounds that the Coal Company was a West Virginia corporation, not qualified to do business in Ohio (R. 175).

The Common Pleas Court issued an attachment which tied up $3477.09 on deposit in the Central National Bank of Cleveland. On June 22, at the time the mines were scheduled to reopen, another national work stoppage was in progress. It was then impossible to resume the production of coal. Because of these conditions, the Coal Company decided to concentrate its efforts upon rehabilitating and improving its properties and to defer the resumption of coal production until the difficulties mentioned could be worked out. Between June 16 and October 9, 1943, the Coal Company employed a large crew of its regular workmen who completed the improvement program at a cost of $30,978.28 (R. 86, 130, 134).

In October, 1943, the District Court appointed A. Spates Brady, operating receiver of the Coal Company's properties. The mines and the equipment had been put in good condition. The OPA price increase was in effect and the miners' wage claims were adjusted November 1, 1943. From the very beginning the receiver has operated the mines at a profit. Monthly reports of the receiver's operations are filed in the District Court.

ARGUMENT.

The definition of insolvency as found in the Bankruptcy Act, Sec. 1 (19) sets forth a workable formula. But for certain specific exceptions, *all* of a debtor's property at a fair valuation is added up and matched against his debts. If the total fair valuation of his property exceeds his debts, then the debtor is solvent. The definition of insolvency as found in the Bankruptcy Act makes no reference to quick assets or property readily convertible into cash. There is no provision in the definition that the property must be available to creditors to satisfy their claims. The only limitation affecting the debtor's property found in Sec. 1 (19) reads:

> "Exclusive of any property which he may have conveyed, transferred, concealed, removed or permitted to be concealed or removed with intent to defraud, hinder or delay his creditors. * * *"

That exclusion is not applicable to this case.

At the trial, the petitioning creditors and intervening creditor, respondents here, contended that in determining solvency no value could be given to the debtor's leasehold and to debtor's machinery, title to which had been acquired by bill of sale. That contention was based upon the provisions of the lease, particularly clauses 9 and 17 (R. 116-118).

The District Court assumed that if the Coal Company was bankrupt the lessors would avail themselves of their

rights to cancel the lease, expel the Coal Company from the property and retake possession of it for themselves. The Trial Court then concluded that the leasehold and the machinery thus being seized by the lessors, would not be available to creditors of the Coal Company, and hence that these properties could be given no value in determining the question of solvency.

Instead of following the definition of insolvency as set forth in Section 1 (19) of the Bankruptcy Act by adding up the fair values of all the debtor's property, the District Court excluded from the calculation the fair value of the leasehold and machinery. These items constituted more than 90% of the debtor's assets.

From September 1, 1942, until October, 1943, and particularly on June 17, 1943, the date of the alleged act of bankruptcy, the debtor in fact conducted its business in the leased premises. They were in the exclusive and unchallenged possession of and being operated and maintained solely by the Coal Company. Since October, 1943, the mines have been operated by the receiver appointed by the District Court. The test of solvency must be made as of the date of the alleged act of bankruptcy, rather than some later date when conditions may be changed, because of rights arising through bankruptcy proceedings.

In re The Cleveland Discount Co., 9 F. (2d) 97 (D. C. Ohio, 1924), the court held at page 98:

> "On issue of insolvency, fair reasonable value of alleged bankrupt's property is to be determined from evidence as of date of alleged act of bankruptcy, and not from subsequent history of property."

To the same effect are the following: *Everett v. Warfield Mining Co.*, 37 F. (2d) 328 (C. C. A. 4, 1930), and *In re Utrecht Coal Co. Inc.*, 63 F. (2d) 745 (C. C. A. 2, 1933).

Jury Question.

It was for the jury to determine the fair value of debtor's machinery. The jury could believe the qualified experts called by the debtor. They testified that the fair value was $292,400.32. Or they could pick any other figure less than that. Merely because the Coal Company had been able to obtain a bill of sale transferring title to the machinery to it for $90,000 cash, is no proof that the fair value of the machinery was limited to that figure. Due to wartime restrictions on manufacturing there had been a substantial increase in price of used mining machinery as new machines were not available in June 1943. Had the testimony of the fair value of the leasehold at $61,457.87 and of the machinery at $292,400.32 as proffered by the debtor, been submitted to the jury and they believed it, then the Coal Company would have been found to have a net worth above all debts amounting to $119,109.97 (R. 129, 192).

The law is definite that a debtor who demands a jury may have the issues of insolvency and the commission of acts of bankruptcy passed on by the jury. In *Burns Bros. et al. v. Cook Coal Co.*, 42 F. (2d) 109 (C. C. A. 3, 1930), the fourth paragraph of the syllabus reads:

"4. Bankruptcy.

Bankrupt's right to jury trial on issues of insolvency and commission of acts of bankruptcy is absolute on proper application."

Warner Coal Corp. seasonably demanded a jury trial on October 19, 1943 (R. 16).

The grantors on the bill of sale were the same parties who are lessors in the lease. It is easy to understand why these same parties, at once lessors and sellers, would convey title to the machinery for less than its fair value in order to gain the far greater benefits to be derived from the twenty-year lease. There were ten million tons of unmined

coal in these properties. At a royalty of 12¢ per ton, the lessors were to receive $1,200,000 over the twenty years, or an average annual income of $60,000. During the lease, all expenses of maintenance and taxes were to be borne by the Coal Company.

It was not the function of the Circuit Court to substitute itself for the jury in testing solvency, and to determine what the fair value of the leasehold and the machinery amounted to. If the District Court erred in ruling that the machinery had no value, for the purpose of testing the debtor's solvency, then the judgment based thereon should have been reversed. In its opinion, the Circuit Court comments on the proffered testimony that the fair value of the leasehold was $61,457.87 and of the machinery was $292,400.32 and says:

> "* * * and the value of the equipment and machinery was based upon qualified expert opinion." (R. 192.)

Neither the petitioning creditors nor any intervening creditor offered any evidence to show that the fair value of debtor's property was less than that testified to by the Coal Company's experts. *In the District Court, this case turned entirely on the contention made by petitioning creditors with which the trial judge agreed, that for the purpose of determining solvency, the leasehold and the machinery had no value whatever.*

The opinion of the Circuit Court seems to agree with our view that the leasehold and machinery are valuable assets. However, the Circuit Court refused to consider the proffered and uncontradicted testimony of the fair value of debtor's property as a going concern. Instead it substituted its own appraisal, based solely upon the cash consideration paid for the machinery. Later in its opinion, the Circuit Court said:

> "* * * there was no evidence that the interest of the Coal Company in the machinery and equipment had a greater value than the sum of $90,000 at which the

> Coal Company had purchased it and was carrying it on its books. Encumbered as it was with the obligation that it would be used and subjected to wear and tear for a long period in mining operations, it cannot be said, in the absence of any evidence, that it had a greater value in the hands of the Coal Company." (R. 193.)

From the language just quoted we see that the Circuit Court valued the machinery conveyed to debtor by bill of sale at $90,000. That sum represented both the amount of cash paid for it and the figure at which it was carried on the debtor's books. The law is well established that in determining solvency in an involuntary bankruptcy, assets are to be considered at their fair value and not necessarily the amount at which they are carried on the debtor's books. We refer particularly to the third and fourth paragraphs of the syllabus of *Stitzer Hotel Co. v. Beyer, et al.*, 55 F. (2d) 620 (C. C. A. 3, 1932):

> "3. Mere fact that company's books show operating loss over period of time does not prove company 'insolvent' within Bankruptcy Act.
>
> 4. In determining whether company was 'insolvent' within Bankruptcy Act, fair value of all assets and capital of business must be considered."

The Circuit Court has either adopted the untenable holding of the District Court that the leasehold and machinery are not property in testing solvency, or it has substituted itself for the jury and appraised debtor's property at less than its fair value to a going concern. The judgment is in conflict with the decisions of two other Circuit Courts.

Debtor's Property.

The Fifth Circuit Court in the case of *Lasswell v. Stein-Block Co., et al.*, 93 F. (2d) 322, ruled that Section 1 (19) of the Bankruptcy Act contemplates that in determining solvency *all* of the debtor's property exclusive of that concealed or transferred to hinder, delay or defraud

creditors, must be included at a fair valuation. The basis upon which the question was raised is the same in the Fifth Circuit case as in our case, namely that the property in question might not be readily available for creditors.

The Fifth Circuit Court held that the debtor's exempt homestead should be included in computing solvency, because there was no indication of Congressional intent to exclude such property. In our case, the judgments of the District Court and the Fourth Circuit Court based upon excluding the fair value of the leasehold and machinery are, therefore, in direct conflict with the judgment of the Fifth Circuit Court.

Going Concern.

The law is clear that so long as the debtor is, in fact, conducting its business, it is a going concern and is entitled to have all its properties valued as such. This means that the value of machinery is not limited to what it might bring at auction or at a forced sale, or only to the cash paid for it, because the sellers obtained other important benefits from a twenty-year lease. The fair value is what that machinery is worth in place to a company able to use it there. The Sixth Circuit Court so ruled in the case of *In re Nathanson Bros. Co.*, 64 F. (2d) 912. The third syllabus of that case reads as follows:

> "If business of alleged bankrupt is in fact being conducted at time of alleged bankruptcy, then items of property constituting its assets must be considered as property of 'going concern' for purpose of determining whether alleged bankrupt is solvent."

At page 913 of its opinion, the court says:

> "Section 1 of the Bankruptcy Act, 11 U. S. C. A. Section 1 provides that a person shall be deemed insolvent within the provisions of this title 'whenever the aggregate of his property * * * shall not, at a fair valuation, be sufficient in amount to pay his debts.' This court has held that in arriving at such fair valua-

tion the property of the alleged bankrupt must be considered as the property of a going concern, that is, as property adapted to and used for the purpose of carrying on the business in question. *In re Klein* (C. C. A.) 197 F. 241. Doubtless the underlying principle of going concern value attaches to property, considered in the aggregate, by reason of its having been assembled for the conduct of the given business and its fitness for such use. *We do not think that the financial outlook of the debtor corporation, or the intention of its stockholders and directors to continue business or liquidate at an early date, is determinative of the question.* If the business is in fact being conducted at the time of alleged bankruptcy, then the items of property constituting its assets must receive a fair valuation, not as isolated articles separated from the whole, *but as parts of the whole and as useful in that relationship.* That is all that is meant by going concern value." (Emphasis ours.)

In our case the Fourth Circuit Court by affirming the judgment of the District Court deprived the debtor not only of going concern value for its leasehold and machinery, but all value. In so holding the judgment is directly in conflict with that of the Sixth Circuit Court in the *Nathanson Bros.* case.

We have found no cases decided by the Supreme Court dealing with the points at issue here. This case concerns the right of a debtor in an involuntary bankruptcy action, on the question of solvency, to include in its list of property at fair valuation, its leasehold which is in good standing, and its machinery, title to which was acquired by bill of sale.

Definition of Insolvency.

The Bankruptcy Act definition of insolvency Sec. 1 (19) is a sound rule based on contrasting the fair value of debtor's property against the total of his debts. We are not here concerned with the popular conceptions of in-

solvency, or indeed other tests of insolvency as used in several state laws, or by bank examiners or stock exchanges wherein the chief element is the ability to meet debts when they fall due. Nor are we concerned with the rights of lessors or other creditors *after* an adjudication of bankruptcy.

CONCLUSION.

The judgment of the Fourth Circuit Court is clearly in conflict with the decision of the Fifth Circuit Court in *Lasswell v. Stein-Block Co.* and with the decision of the Sixth Circuit Court in *In re Nathanson Bros. Co.* The three questions presented in the petition for writ of certiorari at the head of this brief concern a matter of great general interest which should be settled by the Supreme Court. We have been unable to find any decision of this Court dealing with what is property, and the fair value thereof in determining solvency, in an involuntary bankruptcy. We urge this Court to grant a writ of certiorari to the Fourth Circuit Court of Appeals, to the end that the judgment below may be reversed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, A. D. 1944.

No. 698.

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PETITION FOR WRIT OF CERTIORARI
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FOR THE FOURTH CIRCUIT.

BRIEF FOR RESPONDENTS.

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In the Supreme Court of the United States

OCTOBER TERM, A. D. 1944.

No. 698.

WARNER COAL CORPORATION,
Petitioner,

vs.

COSTANZO TRANSPORTATION COMPANY, *et al.*,
Respondents.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FOURTH CIRCUIT.

BRIEF FOR RESPONDENTS.

STATEMENT OF FACTS.

We shall in this statement include only those facts which are pertinent to a consideration of the issues raised by the petition for writ of certiorari. Petitioner on August 26, 1942, entered into an indenture of lease under the terms of which it acquired the right under certain conditions to operate the Richland and Costanzo coal mine property for a period of twenty (20) years. It did not acquire fee simple title to the real estate, but merely the right to mine and remove the coal therefrom subject to the payment of monthly royalties and subject to the other conditions of the lease. The lease provided, among other things, that the Lessor would by bill of sale convey to the Lessee certain mining equipment. The lease further provided, however, (Petr's. Ex. 3, Rec. 114) that at the time of its execution the machinery to be conveyed was sufficient to mine and prepare seventy thousand (70,000) tons of coal per month,

and that throughout the terms of the lease Lessee was required to at all times keep in the mines sufficient equipment to mine and prepare seventy thousand (70,000) tons of coal per month. (Sec. 9.) The bill of sale conveying this equipment to the Lessee was subsequently delivered to the Lessee. Therefore, while the Lessee had the right to remove the several pieces of equipment and sell them, it was nevertheless required to immediately replace such equipment with machinery of like capacity. This lease also contained a provision forbidding the subletting or assignment of the lease without the written permission of the Lessors. The undisputed evidence showed that at the time of the cessation of mining operations by Petitioner (June 15, 1943) there was located in the mines only sufficient equipment to mine and prepare between fifty-five thousand (55,000) and sixty thousand (60,000) tons of coal per month. (Rec. 157.) Therefore, on June 15 all of the machinery and equipment located in the mines was required by the terms of the recorded lease agreement to remain on the premises. Petitioner, about September 1, 1942, commenced mining operations under the lease and continued the operation of the mines thereafter until June 15, 1943, at which time it closed the mines, and they were not again operated until about October 22, 1943, when an Operating Receiver was appointed by the Federal District Court as a result of the commencement of this action.

In its brief Petitioner suggests, as it did in the lower Courts, that the closing of the mines on June 15 was a temporary suspension of mining operations. The facts are to the contrary. On June 12, 1943, Mr. Geddes, Executive Vice President of Petitioner, wired Deputy Solid Fuels Administrator for War that unless the Federal Government gave Petitioner financial assistance the mines would be closed permanently on June 15. (Rec. 164.) The financial assistance was not forthcoming, and the mines were closed on the date fixed. As shown by the minutes of Peti-

tioner's Board of Directors, on June 15 the company did not have sufficient capital to meet payrolls. (Rec. 146.) Petitioner, during every month that it operated the mines, did so at a loss, until during the first half of the month of June, 1943, Petitioner's cost of mining and preparing its coal was Fifty-one Cents (51¢) per ton in excess of the maximum selling price under the Code. Furthermore, Petitioner's Board of Directors in its meeting on June 15, 1943, recites in its minutes that it was necessary to close the mines because its financial condition was such that it could not meet its obligations in an orderly manner. (Rec. 146 and 151.)

As appears from Petitioner's brief, it paid Ten Thousand Dollars ($10,000.00) for the leasehold and Ninety Thousand Dollars ($90,000.00) for the bill of sale to the mining equipment, and these items were listed at these values less depreciation in all of Petitioner's balance sheets except those reconstructed for the purpose of this litigation. Excluding from Petitioner's claimed assets the market value of the machinery and the value of the leasehold, Petitioner had an actual deficit of Two Hundred Forty Thousand Four Hundred Thirty-five Dollars and Thirty-eight Cents ($240,435.38).

NO REASONS PRESENTED FOR ALLOWANCE OF WRIT OF CERTIORARI.

The only reason offered by Petitioner for the allowance of the writ of certiorari is that the decision of the Circuit Court of Appeals in the instant case is in conflict with the decision of the Fifth Circuit in the case of *Lasswell vs. Stein-Block Co., et al.*, 93 F. (2d) 322, and with the decision of the Sixth Circuit in the case of *Re Nathanson Bros. Co.*, 64 F. (2d) 912. Even a cursory examination of those cases and of the facts in the instant case requires the conclusion that the principles of law announced in the decisions of the Fifth and Sixth Circuits are not applicable

to the facts in this case. Both of the decisions cited were argued at length to the District and Circuit Courts below. The *Lasswell* case holds simply that a community homestead which is exempt from execution in the State of Texas may nevertheless be included among the assets of an alleged bankrupt, although this property may not be sold without the alleged bankrupt's wife's consent. The distinction between that case and the facts here involved is that the alleged bankrupt in the *Lasswell* case owned property which was not subject to liens or encumbrances, whereas the coal mining machinery was subject to an encumbrance in the nature of a mortgage which placed the Lessor in a position prior to the Lessee's creditors. This distinction was clearly recognized by the Circuit Court below. Although Petitioner had no legal right to remove any of the machinery and sell the same without immediately replacing it, Petitioner proceeded to trial in the District Court upon the assumption that it owned the equipment outright and could sell it without satisfying its prior obligation (which was a matter of record) to the Lessor. Petitioner offered evidence of the market value of the several items of machinery and equipment. This evidence, in view of the terms of the lease under which the equipment was acquired, was clearly incompetent. The most that Petitioner could be said to own by virtue of the lease agreement and the bill of sale was a right to operate the mines and use the equipment in accordance with the terms of the lease.

The Nathanson Bros. Co. case, *supra,* holds simply that:

> "If business of alleged bankrupt is, in fact, being conducted at time of alleged bankruptcy, then items of property constituting its assets must be considered as property of 'going concern' for purpose of determining whether alleged bankrupt is solvent."

There is no conflict between the decisions of the Courts below and the decision of the Sixth Circuit in the case above

quoted. In the first place, as appears clearly from the statement of facts herein, Petitioner was not after June 15, 1943, a going concern. It was "in fact" defunct. Its only business was that of mining and selling coal, and after June 15 it neither mined nor sold a ton. Furthermore, even if we should indulge the assumption that Petitioner was a going concern, then we are confronted with the fact that there is no evidence in the record to indicate that Petitioner had any going concern value. All of the evidence showed that Petitioner operated at a loss during every month, and that the extent of its loss became progressively greater with each additional month's operations. Petitioner has argued that the book value of its leasehold ($9,557 plus some alleged improvements) should be included as an asset. While we disagree with this contention because of the nonassignability of the lease and other facts of legal significance, it should be pointed out that the inclusion of this item as an asset on the theory of going concern value or some other basis would be of little help to a debtor insolvent in excess of Two Hundred Forty Thousand Dollars ($240,000.00). The Circuit Court of Appeals, as appears from the language of its opinion, gave Petitioner the benefit of every doubt when it stated:

> "* * * there was no evidence that the interest of the Coal Company in the machinery and equipment had a greater value than the sum of $90,000 at which the Coal Company had purchased it and was carrying it on its books. Encumbered as it was with the obligation that it should be used and subjected to wear and tear for a long period in mining operations, it cannot be said, *in the absence of any evidence*, that it had a greater value in the hands of the Coal Company." (Rec. 193.) (Italics supplied.)

There is, therefore, no basis for Petitioner's argument that the decision of the Circuit Court of Appeals herein is in conflict with the decisions of other Circuit Courts.

Clearly, there are no special or important reasons for a review of this case. It is an ordinary run-of-mine bankruptcy case which has been ably considered and accurately decided by the two lower Courts.

The remainder of Petitioner's brief presents nothing in addition to that urged before the Circuit Court of Appeals. Soper, Circuit Judge, in the opinion of the Court ably discusses and disposes of Petitioner's argument. (Rec. 187.)

For the foregoing reasons we submit that the writ of certiorari should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, A. D. 1944.

No. 698.

WARNER COAL CORPORATION, DEBTOR,
Petitioner,

vs.

COSTANZO TRANSPORTATION COMPANY, *et al.*,
Respondents.

PETITIONER'S REPLY BRIEF ON PETITION FOR WRIT.

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WARNER COAL CORPORATION, DEBTOR,
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vs.

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Respondents.

PETITIONER'S REPLY BRIEF ON PETITION FOR WRIT.

Petitioner asks this Court to decide whether a debtor resisting involuntary bankruptcy proceedings can be denied the right to include his leasehold, machinery and equipment in his list of assets, merely because the lease gives the lessor the option, if bankruptcy be adjudicated, to cancel the lease and repossess the premises, including machinery and equipment. Petitioner further asks this Court to decide whether such provision in the lease deprives the debtor of his right to have his assets valued as those of a going concern. Finally, petitioner asks this Court to decide whether a debtor can be denied the right to have a jury find the fair value of his assets and determine whether his business is in fact a going concern.

Respondents' brief, ignoring the vital questions presented in our petition, relies on the fact that the debtor was short of cash and on the fact that its leasehold and machinery were carried on its books at less than fair value. Inability to meet current bills as they fall due is not the test of bankruptcy. It is equally well established that the debtor's book values of his assets are not controlling in bankruptcy proceedings.

The Sixth Circuit Court of Appeals in the case of *In re Nathanson Bros. Co.*, 64 F. (2d) 912, said:

> "We do not think that the financial outlook of the debtor corporation, or the intention of its stockholders and directors to continue business or liquidate at an early date, is determinative of the question. If the business is in fact being conducted at the time of alleged bankruptcy, then the items of property constituting its assets must receive a fair valuation, not as isolated articles separated from the whole, but as parts of the whole and as useful in that relationship. That is all that is meant by going concern value."

The Third Circuit Court of Appeals in the case of *Stitzer Hotel Co. v. Beyer, et al.*, 55 F. (2d) 620, said in the syllabus:

> "3. Mere fact that company's books show operating loss over period of time does not prove company 'insolvent' within Bankruptcy Act.
>
> 4. In determining whether company was 'insolvent' within Bankruptcy Act, fair value of all assets and capital of business must be considered."

RIGHT TO JURY FINDINGS.

Debtor in this case demanded a jury trial so that the questions of fact could be passed on by a jury. The opinion of respondents' counsel that debtor was not a going concern proves nothing. That was one of the important issues of fact that the jury should have passed on. Again, the fair valuation of debtor's property is a vital question of fact in involuntary bankruptcy proceedings. The jury should have been permitted to find it, allowing whatever reduction in value might be appropriate because of the terms of the lease. The Bankruptcy Act, Sec. 1 (19) provides that all of the debtor's property, but for the exception specifically mentioned and not applicable here, shall, at fair valuation, be matched against his debts to determine solvency.

Respondents' brief makes no comment on the most fundamental question of law raised in our petition for writ

of certiorari,—that the debtor is entitled to have the jury pass upon the issues of fact. The attempts to distinguish the facts in the instant case from those in the Fifth Circuit case of *Lasswell v. Stein-Block Co., et al.*, 93 F. (2d) 322 and those in *In re Nathanson Bros. Co.*, only emphasize the aptness of those cases and the clear conflict of law between this decision by the Fourth Circuit and the decisions of the Fifth and Sixth Circuits.

NOVEL QUESTIONS.

Novel questions of law not yet passed upon by the Supreme Court and concerning which the Circuit Courts are in conflict are presented in this case. As the bankruptcy laws affect all business there should be no doubt concerning the important question of what are assets to be included in determining solvency.

If the rule of law announced in this case by the Fourth Circuit is correct, that a debtor, occupying leased premises in which he has made improvements and wherein is located machinery to which he has an absolute title, may not count those assets in determining solvency in bankruptcy proceedings, then a radical departure has been made from generally accepted accounting practices. No longer will accountants be able to certify balance sheets of business establishments showing leasehold and machinery in the leased premises as assets, if the lease contains the common provision against bankruptcy found in this petitioner's lease.

We earnestly request this Court to grant a writ of certiorari to the Fourth Circuit Court of Appeals to the end that the judgment below may be reversed.

Respectfully submitted,

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